Mentor Monthly Missive

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New help for underwater homeowners

On Oct. 24 last year, the federal government announced changes to the Home Affordable Refinance Program (HARP). The new version is designed to help people who were previously unable to refinance their mortgages because the real estate slump had destroyed the equity in their homes. The new rules, announced by the FHFA, Fannie Mae and Freddie Mac, eliminate all limits on mortgages relative to property values. In addition, guidelines have been eased relative to mortgage-payment history. You cannot have had any 30-day delinquencies in the last six months, and no more than one 30-day delinquency in the six month period prior to that. Even if you have recent late payments, you still have time to qualify, as the program has been extended to Dec. 31, 2013.

The benefits are potentially amazing. Your new mortgage will be at today's low rates, which are in the 4% range on a 30-year term. An example of potential savings: If you owe $300,000 and have a current interest rate of 6%, amortized over 30 years, your payment (principal and interest) would be $1,799. The same loan with a 4% rate would have a payment of $1,432, a savings of $367 per month. You may also have the opportunity to switch to a shorter term loan (allowing you to reduce your principle balance sooner). Of special interest to those who have fallen on hard times in prior years will be the elimination of bankruptcy and foreclosure-seasoning requirements. Prior bankruptcy and foreclosures on your credit report will not disqualify you. In fact, you should not have to meet any credit or income qualifying requirements unless the refinance produces an increase of more than 20% in your principle and interest payment. To qualify, your mortgage must be owned by Fannie Mae or Freddie Mac and must have been securitized prior to June 1, 2009. You can find out if you have a Fannie or Freddie loan by going to fanniemae.com or freddiemac.com.

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Meet our Wealth Managers

Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

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Who put the "ill" in Illinois?

Just when we thought it couldn't get any worse for this hapless state, it has: Employers are being hit with burdensome new taxes because Illinois has failed to repay loans it took for unemployment benefits.

We understand that these have been tough times. But the utter failure of our leaders in Springfield to deal with such times in an effective and efficient way – in fact to exacerbate our problems – leaves little room for optimism.

Add the following fiascoes to the additional unemployment tax Illinois is foisting on struggling businesses:

• An increase in the Illinois income tax of 66% – just when struggling wage-earners can least afford it;

• Increases in basic unemployment tax rates of nearly 15% for new businesses whether or not they have had any claims. No wonder nobody is hiring;

• The laughingstock that our elected ex-governor, Rod Blagojevich, has made of each citizen of Illinois;

• The atmosphere of sleaze that continues to pervade Springfield after the conviction of influence peddlers Tony Rezko and Bill Cellini. We have to believe that they and Blagojevich are just the tip of the iceberg.

• The state pension dilemma: Promising benefits for public employees that can never be funded, and legislators rigging the system to give favored people hundreds of thousands of dollars of benefits for working a single day. Who's going to end up paying for this? Look in the mirror.

• Handing out big tax breaks to get Motorola and Sears to stay in Illinois – then for Sears to announce it's closing as many as 120 stores. Another example of the big businesses throwing their weight around at the expense of the little guys – you and me.

• The Cubs – need we say more?

Who is to blame for the mess that is Illinois government? We are – the citizens of Illinois who continue to elect the very people who have created the problems then gone on vacation when it came time to solve them. What's the solution? We'd like to suggest jail time for each and every legislator, charged with the crime of official misfeasance. But that would put undue stress on our already bulging prisons.

We have the power to change; it's the power of the ballot. We need to support and elect honest public servants who will work for the common good, not just for themselves. If there are any of those out there, please step forward.

Monthly Market Commentary

2011 ended with the S&P 500 almost flat after a tumultuous year. As Europe continued to be of concern, markets loved the coordinated central bank maneuver that ensured liquidity across global financial systems in order to calm panicky investors. Although a global economic slowdown is very real, given the possibility of a European financial contagion and a slowdown in China, the U.S. could potentially be the engine of worldwide growth in 2012.

Employment: December saw the addition of 212,000 private-sector jobs, mostly from large increases in delivery personnel, retail sales workers, and construction workers. The holiday season and the boom in online shopping activity accounted for the two former, while unusually warm weather in December helped the latter. While sizable, the private sector has lost 8.8 million jobs throughout the recession and has only gained back 2.8 million of these jobs. At current growth rates, three additional years are still required to recoup all these jobs. The government sector, on the other hand, continued to shed jobs (another 12,000 jobs in December). This brings the total number of government jobs lost since the recovery to almost half a million. The unemployment rate fell to 8.5% in December, aided mainly by increased employment with some help from labor force dropouts.

Manufacturing: Both government new-order reports and industrial-production reports indicated that the U.S. industrials sector was not declining, with some reports even showing signs of modest growth. Positive new-order reports are particularly important—they help predict production and employment in the upcoming months. The most-recent durable-goods order report reflected strong numbers for autos and airplanes, while others, such as non-defense capital goods, slowed. Higher inventory levels and better pricing for autos and Boeing's anticipated production jump to satisfy deliveries for its 787 Dreamliner contributed to these numbers.

Consumer: This holiday season was a great time to be a consumer, as opposed to a retailer. As consumers continued to spend and take advantage of phenomenal deals and discounts, some retailers saw their margins decline as a result. Luxury and low-end retailers did relatively well, but companies serving the middle market, such as Best Buy and Target, struggled. Apparel companies were hit especially hard, given the unusually warm weather in December.

Housing: Stringent lending standards and general attitudes toward home ownership continued to hold back the housing market despite housing affordability remaining at a record high with low prices and low mortgage rates (now below 4%). This could be seen in the 7.3% jump of pending home sales (homes that go under contract but have yet to close, pending appraisals and financing) in November compared with October, which are now at their highest levels in 19 months. However, the housing market continues to underperform, and home prices are still more than 30% below previous highs over the last decade. A catalyst, such as a stronger employment market, may be required before the housing market starts to improve significantly.

Year-end Insights: 2011 saw the U.S. economy grow, but at a much slower rate than predicted by many economists. Poor weather, oil and gas price shocks caused by political unrest in the Middle East, and supply-chain disruptions related to the Japanese tsunami all contributed to the first half's abysmal growth rates. Growth accelerated, as oil and gas prices fell back down and production facilities came back online in the second half of the year. 2011 also brought to light the severity of the European sovereign debt crisis and the slowdown of China's economy, causing investors and companies alike to sit on the sideline, weary of another global recession. Morningstar economists believe that the U.S. economy has more potential for upside than downside in 2012 as consumers continue to spend, manufacturing picks up, U.S. oil production increases, and the housing market becomes stronger.

Borrowing from Your Retirement

Barbara is 40 years old, has a child in college, and needs to take out a loan to help with tuition. She is considering either a home-equity loan or a loan from her 401(k), and is not sure which would be the better choice. She has heard that taking out a loan from a 401(k) is painless, since "you don't pay penalties and pay the interest to yourself, not to a bank." What should she do?

Many 401(k) plans offer a loan provision and the process is fairly easy. There is no credit check (since you are borrowing from yourself); the interest rate is usually low (maybe a percentage point or two above prime); you can generally borrow up to 50% of your vested account balance to a maximum of $50,000; you have up to five years to repay the loan (longer for loans used to purchase a primary residence), and the plan administrator usually deducts the loan payments automatically from your paycheck.

However, the real cost of borrowing from your 401(k) is not the rate you pay yourself in interest, but the amount you would have earned on your balance had you just left the money in the account. This is called an "opportunity cost," and it can be significant. In addition, if Barbara loses or changes jobs, a 401(k) loan will most likely come "due in full" within a limited amount of time, while a home-equity loan will not. The balance is taxed as if it were ordinary income and, unless she is at least 59½ years old, failure to pay the 401(k) loan back by the due date triggers a 10% penalty.

So, what are Barbara's choices? In general, if she can take out a home-equity loan at a lower after-tax cost than the return she expects to receive on her 401(k), she should choose the home-equity loan.

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